

Before the  
FEDERAL COMMUNICATIONS COMMISSION  
Washington, D.C. 20554

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FEDERAL COMMUNICATIONS COMMISSION  
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In the Matter of	)	
	)	
1998 Biennial Regulatory Review --	)	CC Docket No. 98-137
Review of Depreciation Requirements	)	
for Incumbent Local Exchange Carriers	)	
	)	
United States Telephone Association	)	ASD 98-91
Petition for Forbearance from	)	
Depreciation Regulation of Price Cap	)	
Local Exchange Carriers	)	

**REPLY COMMENTS  
OF THE  
UNITED STATES TELEPHONE ASSOCIATION**

The United States Telephone Association (USTA) hereby files its reply comments to the comments filed regarding the Notice of Proposed Rulemaking in the above-captioned docket<sup>1</sup> and responds to arguments concerning the above-captioned USTA Petition for Forbearance from regulating the depreciation and amortization practices of price cap incumbent local exchange carriers (ILECs).<sup>2</sup> In its comments, USTA urged the Commission to recognize that depreciation regulation is a relic of the days before competition in the telecommunications industry that must be removed so that price cap ILECs can compete on a fair and economically efficient basis. USTA called on the Commission to institute forbearance from depreciation regulation of price

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<sup>1</sup>FCC 98-170, released October 14, 1998 (Notice).

<sup>2</sup>USTA filed its Petition for Forbearance on September 21, 1998. The Commission issued a Public Notice on September 29, 1998 establishing initial comment dates for the petition but revised those filing periods to coincide with the pleading cycle in the Notice in an October 16, 1998 Public Notice, DA 98-2092.

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cap ILECs immediately, rather than institute the measures proposed in the Notice that will do little to remove the extraordinary burdens on ILECs that are imposed by depreciation rules.

**I. The USTA Petition for Forbearance is fully justified and should be granted.**

A number of parties fully support USTA's Petition for Forbearance.<sup>3</sup> Although a few commenting parties oppose grant of the Petition,<sup>4</sup> the arguments advanced by those parties do not constitute a basis for denial of the Petition. Thus, for the reasons stated in its Petition and below, USTA continues to advocate that a compelling basis has been established for the Commission to grant forbearance from depreciation regulation.

**A. Limited relief of depreciation regulation as proposed by the Commission is inadequate.**

USTA and other parties<sup>5</sup> have sufficiently demonstrated that the Commission's modest proposed changes to certain limited elements of depreciation regulation are inadequate and must give way to more serious and fully justified depreciation reform. USTA and the other supporting parties have shown that broad relief is in the public interest, since it would promote competition, improve price cap carriers' efficiency and eliminate unnecessary regulation. Further, USTA and other parties have shown that continued depreciation regulation is not needed to protect consumers, but rather harms consumers by imposing unnecessary administrative burdens and

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<sup>3</sup>Comments of Ameritech, Bell Atlantic, BellSouth, Cincinnati Bell Telephone, GTE, Southwestern Bell Telephone Company, Pacific Bell and Nevada Bell (SBC), and Sprint Corporation (Sprint).

<sup>4</sup>Comments of AT&T Corp. (AT&T), MCI Worldcom, Florida Public Service Commission and Virginia State Corporation Commission.

<sup>5</sup>Comments of Ameritech at 2, Bell Atlantic at 4, BellSouth at 3, Cincinnati Bell Telephone at 11, GTE at 4, SBC at 1, and Sprint.

costs on the subject carriers, and that depreciation regulation is not necessary to ensure that price cap carriers' charges, practices, classifications, regulations or other activities are just and reasonable or not unjustly or unreasonably discriminatory. The analysis concerning competition and consumer protection set forth in the Affidavit of William A. Taylor and Aniruddha Banerjee attached to USTA's Comments (Taylor Affidavit) is particularly persuasive. The following statements bear emphasis:

The pricing discipline that "robustly" competitive markets may be relied upon to impose in ILECs is already being exerted by price cap regulation. This form of regulation severs the link between the costs and prices of a price cap ILEC, and ensures that inefficient operation by the ILEC is not transmitted forward to consumers in the form of higher service prices....

The inability to transmit changes in cost (whether or not triggered by changes in depreciation rates) into prices of services subject to price cap regulation offers the best possible protection for consumers. While prices of those services are capped formulaically by the rate of inflation and a productivity offset factor, prices of the ILEC's *competitive* services are subject to the checks and balances that exist in a competitive market. Therefore, the *degree* of competition itself for services subject to price cap regulation matters only for determining when services currently under price caps should be transitioned to the category of competitive services (i.e., out of price caps). The degree of competition does *not* determine whether forbearance from depreciation prescription affects the prices of price-capped services one way or the other.<sup>6</sup>

**B. Opposition to forbearance is unsubstantiated.**

Those parties opposing USTA's Petition for Forbearance only make general and unsubstantiated complaints concerning the adequacy of the showing made to justify forbearance.<sup>7</sup> USTA and the other parties supporting the Petition for Forbearance have already fully addressed these complaints directly and with factual, practical solutions to the minor issues raised in the Notice and by opponents. However, two allegations warrant further comment.

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<sup>6</sup>Taylor Affidavit at 9-10.

<sup>7</sup>Comments of the Ad Hoc Telecommunications Users Committee (Ad Hoc Users) at 3-6, AT&T at 2-3, 10-26, and MCI Worldcom at 1-2, 15-17.

One contention made by AT&T is that forbearance is not a substitute for notice and comment rulemaking and is not appropriate where a forbearance request seeks to substantially modify Commission rules.<sup>8</sup> The case cited<sup>9</sup> as support for this premise is inapposite to the USTA Petition since the cited case sought relief not only in the form of forbearance but also for streamlining Part 36 of the Commission's rules. The USTA Petition does not seek modification of the depreciation rules, only forbearance from them for price cap carriers. The whole purpose of a request for forbearance is to seek forbearance from existing rules, not to change the rules *per se*.

The other argument concerns the legislative intent of Section 220 (b) of the Communications Act of 1934, as amended.<sup>10</sup> AT&T contends that Section 220 (b) was amended in 1996 to recognize that the Commission needs to focus its attention on larger ILECs, not to deregulate the depreciation practices of those carriers.<sup>11</sup> MCI Worldcom contends that Section 220(b) merely affirmed the Commission's existing depreciation practice by limiting prescription to "such carriers as it deems appropriate."<sup>12</sup>

As USTA made clear in its Petition for Forbearance,<sup>13</sup> the changes in the 1996 Act to

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<sup>8</sup>Comments of AT&T at 12.

<sup>9</sup>*Id.* n. 25. *New England Telephone and Telegraph Company and New York Telephone Company*, Petition for Forbearance from Jurisdictional Separations Rules, AAD 96-66, *Order*, 12 FCC Rcd 2308, 2313-15 (1997).

<sup>10</sup>47 U.S.C. § 220 (b).

<sup>11</sup>Comments of AT&T at 15.

<sup>12</sup>Comments of MCI Worldcom at 16-17.

<sup>13</sup>USTA Petition for Forbearance at 3-5.

Section 220(b) were made for the purpose of giving the Commission greater flexibility in setting depreciation rates for carriers. This was substantiated by the Joint Explanatory Statement of the Conference Committee.<sup>14</sup>

**II. No valid basis exists for continued regulation of depreciation prescription for price cap ILECs. Rather, the Commission should enact serious depreciation reform.**

Several parties raise specific arguments that attempt to prop up outmoded depreciation regulation of price cap carriers. Those positions neither support retention of existing depreciation regulation nor denial of the USTA Petition for Forbearance from depreciation regulation. Each of those arguments is discussed below.

**A. The elimination of the sharing mechanism does alleviate the need for depreciation regulation.**

MCI Worldcom takes issue with USTA's position that the elimination of the sharing mechanism alleviates the need for depreciation regulation.<sup>15</sup> The MCI Worldcom objection has been adequately addressed in several parties' comments,<sup>16</sup> where it is pointed out that an earnings-based sharing component was the primary basis for not deregulating or forbearing from regulating price cap ILECs in 1993, when the Commission adopted only limited streamlining.<sup>17</sup> Now that the Commission has eliminated earnings sharing, there is no longer any basis for continued depreciation regulation.

Despite this fact, the Commission offered a number of other excuses for continuing

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<sup>14</sup>*Id.* at 4, quoting the Joint Explanatory Statement of the Committee of Conference, *printed in* H.R. Conf. Rep. No. 104-58 (Jan. 31, 1996) at 186.

<sup>15</sup>Comments of MCI Worldcom at 16.

<sup>16</sup>Comments of Bell Atlantic at 3, SBC at 5, and USTA, Taylor Affidavit at 9.

<sup>17</sup>*Simplification of the Depreciation Prescription Process*, 8 FCC Rcd 8025 (1993).

depreciation regulation for the price cap ILECs in the Notice. As observed by SBC, “[i]t is counter-intuitive that, under the deregulatory national policy framework of the 1996 Act, the number of reasons to retain burdensome depreciation regulation would multiply rather than shrink, compared to the less competitive and more regulatory environment in 1993, when the Commission only identified one significant obstacle to meaningful deregulation - sharing. It is also strange that most of these additional reasons are not based on new developments or new regulations that did not exist in 1993.”<sup>18</sup>

**B. The price cap mechanism severs the ties of a carrier’s price to costs and negates any market power argument.**

AT&T contends that ILEC market power precludes depreciation reform because depreciation is a substantial cost item in the capital intensive telecommunications industry that ILECs may manipulate to justify higher access prices.<sup>19</sup>

The fact is that price is regulated by the price cap mechanism which is derived from economic factors. Any attempt to manipulate depreciation expenses would not cause a change in price cap ILECs’ access prices. AT&T refers to a study by its own consultants<sup>20</sup> that agrees that the price cap regulatory mechanism has removed any link between operating costs and prices. The AT&T study states that “During the period 1990 to present (if not earlier), the ILECs have

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<sup>18</sup>Comments of SBC at 5.

<sup>19</sup>Comments of AT&T at 12-13.

<sup>20</sup>See Comments of AT&T n. 22 which cites *Assessing Incumbent LEC Claims to Special Revenue Recovery Mechanisms: Revenue Opportunities, Market Assessments, and Further Empirical Analysis of the ‘Gap’ Between Embedded and Forward-Looking Costs*, Economics and Technology, Inc., Appendix B to AT&T’s January 29, 1997 Comments in Access Charge Reform, CC Docket No. 96-262.

been successful in their efforts to get out from under ROR with its emphasis on historical embedded costs and to enjoy the increased freedom under price cap regulation to make market-driven decisions. Price cap regulation was expressly intended to sever the link between prices and costs....”<sup>21</sup> AT&T’s arguments here are disingenuous since AT&T itself was under price cap regulation for a number of years and knows intimately the relationship between cost and price in a price cap environment.

**C. The level of the productivity factor for price cap ILECs is not relevant to the issue of depreciation regulation.**

AT&T argues that the absence of lower formula adjustment filings by the ILECs is a sign that the price cap formula productivity factor has not been set at a level that fairly reflects the gains possible in the industry.<sup>22</sup> In order to justify including an argument on the level of the price cap formula productivity factor, AT&T mischaracterizes the proposals that USTA has set out in its Petition for Forbearance of depreciation regulation. AT&T states that USTA proposed that the Commission limit depreciation regulation to those ILECs filing for lower formula adjustments.<sup>23</sup> AT&T then states that USTA has mistakenly relied on the number of lower formula adjustment (LFAM) filings as a signal that depreciation regulation is not necessary when it is instead a signal that the price cap formula productivity factor is too low.<sup>24</sup>

USTA did not rely on the number of LFAM filings for justification for forbearance. What USTA did propose was, “... if a price cap LEC seeks to implement a low end adjustment

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<sup>21</sup>*Id.*

<sup>22</sup>*Id.* at 16.

<sup>23</sup>*Id.* at 17.

<sup>24</sup>*Id.* at 15.

after forbearance takes effect, USTA recommends that the LEC should be responsible for demonstrating, at the Commission staff's request, that the LEC's depreciation practices are reasonable and did not distort the LEC's reported earnings."<sup>25</sup> Regarding the number of LFAM filings, USTA stated that "Because of the very limited use of the low-end adjustment, forbearance from depreciation regulation of price cap LECs would not have a negligible effect on such price levels."<sup>26</sup> AT&T's distorted attempt to bridge forbearance of depreciation to the level of the price cap formula productivity to argue the level of the productivity factor not only simply fails on its face the test of common sense, but it is irrelevant to this proceeding.

**D. Depreciation factors are not dependent on support of exogenous factor adjustments, new service rates or rates above existing price caps.**

AT&T attempts to defend continued depreciation regulation as necessary to support exogenous factor adjustments, new service rates and rates above existing price caps.<sup>27</sup> USTA has addressed each of these concerns and demonstrated that forbearance from depreciation regulation would have either no effect or *de minimis* effect that could be easily monitored when circumstances warrant.<sup>28</sup> In each area, the Taylor Affidavit set out specifically how the Commission's price cap rules are effective safeguards against those concerns raised by AT&T.

**E. An ILEC should be able to recover depreciation reserve deficiencies absent effectiveness of depreciation regulation.**

Ad Hoc Users claims that ILECs should be precluded from recovering depreciation

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<sup>25</sup>USTA Petition for Forbearance at 12.

<sup>26</sup>*Id.* at n.33.

<sup>27</sup>Comments of AT&T at 18.

<sup>28</sup>Comments of USTA, Taylor Affidavit at 13-16.

reserve deficiencies or other takings claims if they have the flexibility to set their own depreciation rates.<sup>29</sup> Ad Hoc Users' concern is that ILECs would have the opportunity to charge excessive prices for access services. Ad Hoc Users clearly misunderstood USTA's position regarding this issue.<sup>30</sup> USTA proposed that ILECs should not be precluded from making their case to recover any depreciation reserve deficiencies that may exist. The Taylor Affidavit explains that forbearance from depreciation regulation resulting in depreciation rates selected by an ILEC cannot create an exogenous cost event.<sup>31</sup> Furthermore, the Taylor Affidavit clarifies that ILECs have already accepted that recovery of any future depreciation reserve deficiencies that arise after forbearance takes effect should be conditioned on providing an explanation of those deficiencies to the Commission.<sup>32</sup>

### **III. The Commission should grant additional relief to the Mid-Size carriers.**

In the Notice,<sup>33</sup> the Commission proposed to relieve the Mid-Size carriers from the obligation of filing annual theoretical reserve studies. USTA supports the efforts of the Commission to recognize the particular needs and costly burdens of the Mid-Size ILECs and to grant additional relief to those carriers. Grant of the USTA Petition for Forbearance from depreciation regulation would provide more extensive and much warranted relief for all carriers, including the Mid-Size carriers. USTA obviously continues to advocate this course of action.

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<sup>29</sup>Comments of Ad Hoc Users at 9.

<sup>30</sup>USTA Petition for Forbearance at 2 n.5.

<sup>31</sup>Comments of USTA, Taylor Affidavit at 15.

<sup>32</sup>*Id.* See also Comments of SBC at 14-16.

<sup>33</sup>Notice at 11.

However, in the alternative, the Commission should consider relief for the Mid-Size ILECs.<sup>34</sup>

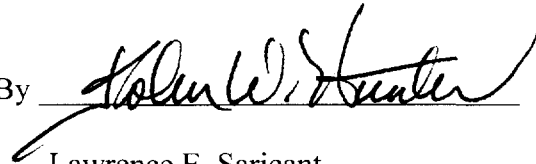
#### **IV. Conclusion**

For the reasons stated herein, USTA strongly urges the Commission to grant its request for forbearance from depreciation regulation of price cap local exchange carriers immediately, rather than institute the measures proposed in the Notice that will do little to remove the extraordinary burdens on ILECs that are imposed by depreciation rules.

Respectfully submitted,

UNITED STATES TELEPHONE ASSOCIATION

By



Lawrence E. Sarjeant  
Linda L. Kent  
Keith Townsend  
John W. Hunter

*Its Attorneys:*

1401 H Street, NW  
Suite 600  
Washington, DC 20005  
(202) 326-7375

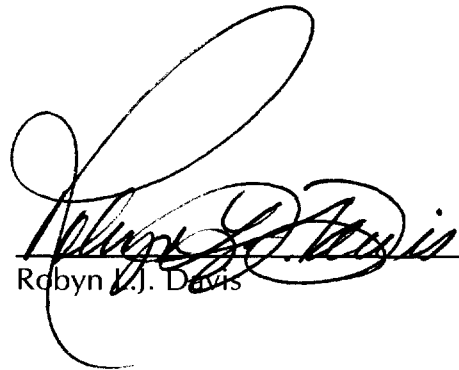
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<sup>34</sup>See Comments of Cincinnati Bell Telephone at Sec. IV, Sprint at 12-13.

**CERTIFICATE OF SERVICE**

I, Robyn L.J. Davis, do certify that on December 8, 1998 copies of the Reply Comments of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.



Robyn L.J. Davis

Mark C. Rosenblum  
J. Manning Lee  
AT&T  
295 North Maple Avenue  
Room 3245H1  
Basking Ridge, NJ 07920

Robert D. Shank  
Frost & Jacobs, LLP  
(Cincinnati Bell)  
2500 PNC Center  
201 East Fifth Street  
Cincinnati, OH 45202

Thomas E. Taylor  
Cincinnati Bell  
201 East Foruth Street  
Sixth Floor  
Cincinnati, OH 45202

Jay C. Keithley  
Sprint  
1850 M Street, NW  
11<sup>th</sup> Floor  
Washington, DC 20036

Sandra K. Williams  
Sprint  
4220 Shawnee Mission Parkway  
Suite 303A  
Westwood, KS 66205

Edward D. Young III  
Michael E. Glover  
Edward Shakin  
Bell Atlantic  
1320 North Court House Road  
Eighth Floor  
Arlington, VA 22201

Robert M. Lynch  
Durward D. Dupre  
Robert K. Toppins  
Southwestern Bell  
Pacific Bell/Nevada Bell  
One Bell Plaza - Room 3022  
Dallas, TX 75202

Darryl W. Howard  
Jonathan W. Royston  
Southwestern Bell  
Pacific Bell  
Nevada Bell  
One Bell Plaza - Room 3022  
Dallas, TX 75202

Alan Buzacott  
MCI WorldCom, Inc.  
1801 Pennsylvania Avenue, NW  
Washington, DC 20006

Patricia M. Kravtin  
Economics and Technology, Inc.  
(Ad Hoc Telecommunications Users Comm.)  
One Washington Mall  
Boston, MA 02108

James S. Blaszak  
Levine, Blaszak, Block & Boothby, LLP  
(Ad Hoc Telecommunications Users Comm.)  
2001 L Street, NW  
Suite 900  
Washington, DC 20036

Cynthia B. Miller  
Florida PSC  
Capital Circle Office Center  
2540 Shumard Oak Boulevard  
Tallahassee, FL 32399

William Irby  
Virginia State Corporation Commission  
Box 1197  
Richmond, VA 23218

Leander R. Valent  
Ameritech  
9525 W. Bryn Mawr  
Suite 600  
Rosemont, IL 60018

M. Robert Sutherland  
Stephen L. Earnest  
BellSouth Corp.  
1155 Peachtree Street, NE  
Suite 1700  
Atlanta, GA 30309

Andre J. Lachance  
GTE  
1850 M Street, NW  
Washington, DC 20036

John F. Raposa, **HQE03J27**  
GTE  
600 Hidden Ridge  
P.O. Box 152092  
Irving, TX 75015

ITS  
1231-20th Street, NW  
Washington, DC 20036